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Business and Economic Conditions

New York, March, 1958

General Business Conditions

THE downtrend in business has continued during February. Large-scale layoffs persist in many heavy industries, although scattered rehirings at some steel mills indicate that the decline in that line may be bottoming out. Business men recognize that considerable adjustments, in the form of production curtailment and inventory reduction, are already behind us, but they are not basing plans on hope of a quick upturn; instead they are watchful and cautious. Ordering is very much on a hand-to-mouth basis, and production has been geared down to work off stocks.

Retail trade reports, which had offered some encouragement in December and January, were clearly disappointing in February. Department stores reported that sales in the first three weeks of the month were 11 per cent below the corresponding period of 1957, while sales of new passenger cars slipped lower. Unusually bad weather in February accentuated the declines in trade, construction, and output in many parts of the country. Meanwhile, government authorities have been closely watching developments and taking steps to bolster confidence, ease credit, and stimulate public works and home-building.

The dimensions of the decline became clearer as business reports for January appeared. Industrial production, as measured by the Federal Reserve index (seasonally adjusted, 1947 - 49 = 100), dropped 3 points further in January to 133. Compared with the record of 147 in December 1956, the decline in output is now nearly 10 per cent, approximately the same as the over-all drop in both the 1948-49 and the 1953-54 recessions. Unemployment rose 1,120,000 from mid-December to mid-January, and reached a total of 4,494,000 persons, equivalent to 6.7 per cent of the civilian labor force. This level of unemployment tops anything experienced in the 1953-54 decline but was exceeded in the first two months of 1950. Weekly reports on insured unemployment indicate a moderate further rise in the number out of work through mid-February, as would be expected for seasonal reasons.

Facing a Test

These reports make it clear that business is still soft, but throw little light on future prospects. Hope of improvement in the early future rests largely on two possibilities. One is that the usual spring pickup will check the downtrend. The other is that in many lines at least the decline in industrial operations has brought production so far below consumption, and is cutting inventories so satisfactorily, that a larger output will soon be called for.

A seasonal improvement can have important psychological effects, but it would be a mistake to confuse a purely seasonal rise with real recovery. Ordinarily, total employment might be expected to rise about 3½ per cent between February and May, while unemployment usually drops off. Industrial production normally advances 3½ per cent during the first quarter, but

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loses about half that gain in the second quarter. Retailers expect a pickup in sales soon because of the relatively early Easter this year. Construction, agriculture, and other outdoor pursuits will step up activity and employment when the weather improves. These usual seasonal advances must be allowed for in appraising the reports. The test is whether the pickup falls short of or exceeds normal expectations.

A good illustration of the opening of a gap between production and consumption, even estimating the latter pessimistically, is found in the steel industry. Lack of orders drove average ingot production during January and February down to less than 1.5 million tons per week. This is 40 per cent below the 2.5 million tons per week being turned out a year earlier. Consumption of steel, however, has not declined by anything close to 40 per cent, nor is it expected to do so. Probably the January-to-January decline of 11 per cent in all types of metal fabricating activity is more typical of the contraction in steel consumption. Fabricators all along the line are working down their stocks of metal. Obviously, consumption of steel cannot exceed output indefinitely. The process must stop when stocks have been reduced in line with current production rates and the prompt delivery schedules now prevailing; eventually steel production will have to rise to equal what is being consumed.

Just when this rise will occur is another question. Steel officials believe that the decline in orders and production is at or near bottom; small, rush orders are evidence of low stocks at some plants. However, there are no signs of a large-scale revival of ordering.

Who Are the Unemployed?

In any kind of inventory adjustment, the basic factor is the strength of demand. Through the fourth quarter of 1957, final demand was fairly well sustained. Shifting inventory demand accounted for $5.7 billion of the $7.4 billion decline in gross national product from the third to the fourth quarter, according to the latest estimates. Final demand from consumers, business, and government, however, edged off only $1.7 billion. In 1958, it is apparent that government demand for defense and public works will be on the rise, while business expenditures for new plant and equipment are scheduled to decline. Consumer spending can tip the balance between these forces, but in which direction?

Effective consumer demand depends on income and confidence, and both to a considerable extent reflect trends in employment and unemployment. Actually, over-all employment has held up well. In January the total of 62,238,000 persons at work was only 340,000, or one half of one per cent, less than a year earlier. However, more than 900,000 workers were added to the labor force during the past year, and unemployment rose 1,250,000 to 4.5 million in January 1958.

The quality of unemployment is even more crucial than its quantity in gauging the seriousness of an adjustment period. A couple of years ago, there was a period when statistical unemployment increased mainly because employment opportunities were so good; large numbers of teenagers, elderly persons, and other marginal workers were attracted into the labor force and not all of them found jobs immediately. That sort of unemployment was no drag on the economy. This time, however, the situation is different.

The slackening in demand has been centered in durable goods manufacturing, reflecting lower demand in late 1957 for producers' equipment, defense goods, and consumer durables. Employment in durable goods factories dropped 877,000 between January 1957 and January 1958. The detailed Census figures show that the year-to-year declines in employment and the increases in unemployment are greatest among men 20 to 44 years old and among factory workers, laborers, craftsmen, and supervisors. Significantly, in recent months there has been a sharp increase in unemployment among married men with families.

It would be a good guess that many of the newly unemployed workers are young men in their 20's who had not built up much seniority before the layoffs started, and who were the chief support of relatively new households. In such a case, it would not be surprising if many of them had little savings and were already heavily burdened with consumer credit and mortgage debt. If so, there are clear implications for consumption of goods and services other than necessities.

Stabilizing Income

High employment and rising wage rates have helped keep personal income high. In January, the seasonally adjusted annual rate of personal income was $343.6 billion, $7.3 billion greater than a year earlier and only $3.7 billion below the August 1957 peak. Income from rents, interest, dividends, and farms totaled the same in January as in August, while unincorporated business income was down 3 per cent.

Reflecting both layoffs and shorter hours of work, labor income has declined $5.1 billion

from the August peak. Over two fifths of this drop, however, has been offset by a rise in social insurance benefits and other transfer payments. As noted earlier, the persons laid off in the past year were largely steady industrial workers, who are likely to have built up unemployment insurance or social security credits and thus are assured of a minimum income while unemployed. Private payments, including pensions, annuities, and supplemental unemployment benefits (SUB), are not included in the personal income total, but will add to current spending power.

Offsetting the support these "automatic stabilizers" give to income has been the curtailment of purchasing power through rising consumer prices. In January 1958, the official index of consumer prices (1947-49 = 100) advanced to 122.3, 0.6 per cent above December and 3.5 per cent greater than a year earlier.

Caught in the squeeze between higher grocery bills and a shrinking pay envelope, many consumers are understandably reluctant to make major purchases, particularly when these items too have risen in price. The near-record level of income, the stabilizing influence of transfer payments, and the substantial volume of individual savings will make it possible for consumers to maintain a high over-all rate of spending. However, until there is assurance that the bottom is reached or until some dramatic stimulus to spending occurs, chances of a spontaneous increase in consumer expenditures appear slim.

Corporate Earnings in 1957

Annual reports issued to date by companies engaged in all major lines of business reveal that – on an over-all basis – the earnings drop in the fourth quarter largely cancelled the gains made earlier in the year. Our tabulation of 2,474 statements for the full year shows combined net income after taxes of $15.4 billion, an increase of 1 per cent over the total for 1956. This virtually unchanged total of net income represents a narrower average margin of profit on the substantially increased total of sales or revenues, as well as a lower rate of return on a greatly expanded capital investment.

Separate quarterly figures available for 610 manufacturing companies indicate that net income in the fourth quarter of 1957 was slightly below the third quarter, but 16 per cent below the relatively high fourth quarter of 1956. The following condensed summary shows the predominance of declines in the fourth quarter, while the table on the next page gives a preliminary summary for the full year as reported to date by a much larger number of companies, representing other lines as well as manufacturing.

Net Income of Leading Manufacturing Corporations for the Fourth Quarter, 1956-1957

(In Thousands of Dollars)

No. of Cos.	Industry Groups	1956	1957	% Chg.
49	Food products & bev.	$ 82,882	$ 87,129	+5
10	Tobacco products	44,090	46,921	+6
28	Textiles & apparel	31,420	22,182	—29
36	Paper & allied prod.	71,678	57,955	—19
39	Chemical products	238,459	213,947	—10
26	Drugs, soap, cosmetics	75,090	93,637	+25
43	Petrol. producing & ref.	451,455	309,301	—31
46	Cement, glass, stone	87,180	85,699	—2
35	Iron & steel	343,144	235,281	—31
66	Machinery	108,888	85,800	—21
139	Other metal products	284,705	251,684	—12
50	Autos, other trans. eq.	390,256	370,395	—5
43	Misc. manufacturing	124,998	106,268	—15
610	Total manufacturing	$2,334,254	$1,966,199	—16

For the full year 1957, reports of 1,194 manufacturing companies together showed net income practically unchanged from 1956. Subgroups registering gains include tobacco, shoes, drugs, steel, autos, and other transportation equipment. Those experiencing decreases include textiles, clothing, tires, paper, petroleum, building materials, and miscellaneous metal products. Although about seven out of ten manufacturers reported sales increases, rising costs so squeezed profit margins that only half of them were able to better their net income.

The best earnings, generally speaking, were realized by those industry groups which achieved the sharpest expansion in volume of dollar sales billed. Where sales increased only slightly, the persistently rising trend of costs – labor, materials, services, and taxes – caused net income to rise proportionately less or to dip. Where sales sagged below those of the previous year, earnings usually dropped quite sharply.

Manufacturers' Sales and Earnings

Dollar sales billed hit new highs in a great many cases in line with long-term growth trends, often combined with some rise in selling prices and widespread development of new products. Examples are such industries as food products, tobacco, chemicals, drugs, tires, and some types of equipment. Sales lagged, however, with many producers of textiles, paper, lumber products, cement, and also – particularly toward the year-end – machinery and equipment. Most of the automobile and parts producers pushed up their dollar sales substantially, but changes in net earnings were mixed.

The steel group had small increases, due in part to the comparison against a strike period of 1956, in both sales and net income, although the latter was up less percentagewise than the

Preliminary Summary of Net Income of Leading Corporations for the Years 1956 and 1957
(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income After Taxes 1956	Reported Net Income After Taxes 1957	Per Cent Change
115	Food products	$ 450,766	$ 442,603	— 2
32	Beverages	106,200	114,710	+ 8
14	Tobacco products	169,982	186,633	+10
51	Textile products	127,361	122,996	— 3
28	Clothing and apparel	20,826	18,253	—12
18	Shoes, leather, etc.	32,592	36,639	+12
17	Tires, rubber products	224,545	220,190	— 2
25	Lumber, wood prod.	124,556	84,908	—32
50	Paper and allied prod.	319,462	264,636	—17
54	Chemical products	945,571	930,562	— 2
30	Drugs, soap, cosmetics	299,277	357,330	+19
15	Paint and varnish	43,181	43,283	+—
73	Petrol. prod. & ref.	1,874,878	1,811,588	— 3
61	Cement, glass, stone	366,762	347,561	— 5
41	Iron and steel	1,072,143	1,120,235	+ 4
424	Other metal products	1,925,434	1,871,598	— 3
41	Automobiles & parts	1,183,326	1,344,064	+14
35	Other transp. equip.	193,744	204,644	+ 6
70	Misc. manufacturing	122,904	127,149	+ 3
1,194	Total manufacturing	9,603,460	9,649,582	+—
14	Metal mining	68,583	39,142	—43
17	Other mining, quarry.	67,945	67,872	——
31	Total mining, quarry.	136,528	107,014	—22
25	Chain stores—food	109,913	125,256	+14
39	Chains—variety, etc.	110,958	103,040	— 7
52	Department & spec.	186,151	192,284	+ 3
50	Wholesale and misc.	281,172	275,009	— 2
166	Total trade	688,194	695,589	+ 1
113	Class 1 railroads	881,000	732,000	—17
42	Other transportation	109,208	81,456	—25
155	Total transportation	990,208	813,456	—18
162	Elec. power, gas, etc.	1,320,948	1,402,826	+ 6
13	Telephone & telegraph	849,966	929,739	+ 9
175	Total public utility	2,170,914	2,332,565	+ 7
18	Amusements	27,480	21,384	—22
20	Restaurant and hotel	5,409	5,724	+ 6
40	Other bus. ser. & const.	100,236	115,384	+15
78	Total amuse., ser., etc.	133,125	142,492	+ 7
384	Commercial banks	885,326	971,935	+10
180	Investment trusts	485,239	476,938	+10
64	Sales finance	199,448	211,325	+ 6
47	Real estate	10,584	10,379	— 2
675	Total finance	1,530,597	1,670,577	+ 9
2,474	Grand total	$15,253,026	$15,411,275	+ 1

equity capital investment. The petroleum producers and refiners made sales gains in most cases, but net earnings of the group were down slightly, reflecting some weakening of product prices. Most of the steel and petroleum companies, as already stated, had sharply lower earnings in the fourth quarter.

Lower prices for copper and weakened demand for both copper and aluminum depressed earnings in those industries. Operations of a major electrical equipment producer recovered sharply following a prolonged strike early in '56. Curtailed sales resulting from cut-backs and shifting of national defense contracts were experienced by many producers of aircraft, instruments, and other military equipment.

Annual reports indicate that an important factor in improving earnings, or at least in absorbing rising expenses generally, was the benefits derived from new plant and equipment in expanding output and lowering unit production costs. In some instances, however, these benefits were more than offset by such adverse factors as more keenly competitive conditions, over-expansion of capacity, stepped-up expenditures on research, start-up expense of new facilities, and losses on the liquidation of discontinued lines.

In addition, industrial earnings generally have been held down by the continued upward trend of charges for depreciation and depletion of physical properties, the amounts of which are based upon the soaring costs of the vast postwar program of expansion and modernization. In a number of cases the earnings as reported for last year were reduced by the adoption of the LIFO (last-in, first-out) method of inventory valuation in order to avoid reflecting price rises in earnings.

Trends in Other Lines

Among the reports of 166 retail and wholesale trade organizations, three out of four realized increases in sales last year but, because of rising costs, only three out of five made increases in net income, the total of which was up 1 per cent.

Class 1 railroads last year experienced a drop of 17 per cent in net income. Whereas total operating revenues declined ½ of 1 per cent, operating expenses rose 1½ per cent. Major airlines booked substantially more revenues but, because of rising expenses and the inability to obtain higher rates, suffered a drop in net income.

Reports of 175 systems supplying electric, gas, telephone, and other services maintained in almost every case their long-term growth in revenues. Because of advancing costs, gains in net earnings were by no means assured, however, and one out of five reporting utilities had a dip in net income.

Annual reports of a large number of additional companies are scheduled for publication during March and will be included in our final summary in the April issue of this Letter, which as heretofore will show by more detailed industry groups the average percentage profit margins on sales or revenues, and the rates of return on book net assets or net worth.

Indications are that earnings are dropping further in the first quarter of 1958, leading to numerous cuts in dividends.

Fiscal Policy in Recession

The deepening of the 1958 business recession has aroused widespread discussion of appropriate Federal Government action to encourage a revival of activity. The phase of rapid decline may now be largely behind. The correction of excess inventories should not take many months more. Home construction, helped by readier availability of mortgage money, is being sus-

tained. But there is little ground for expecting any early upturn in such key factors as business investment or export demand. More people are beginning to share the view of Arthur Burns, as stated in an appraisal he gave of the situation two weeks ago, that there may be a need for "massive" government intervention to end the decline and restore full employment. Dr. Burns, who is president of the National Bureau of Economic Research and professor of economics at Columbia University, was chairman of the President's Council of Economic Advisers, 1953-56, and is the nation's foremost student of business cycles.

Dr. Burns, while noting that the decline in over-all activity has been modest as business recessions go — between 2 and 2½ per cent so far — pointed out the political advantages the communist world would reap from a prolonged and severe slump here. An even more immediate concern, in Washington at any rate, is the Congressional election now only eight months away in November. The voters are more in a mood to re-elect their representatives when the atmosphere is one of prosperity.

Question of Timing

Many experts, in and out of government, looked for a deep depression immediately after World War II. The troubles that actually developed in 1946 stemmed from shortages of consumer goods and long and bitter strikes which prolonged the shortages and intensified upward pressures on prices. Since then we have had two mild recessions, in 1949 and 1954. The 1958 recession so far is no larger than those were but it is entitled to be treated with more respect. A decade or so after each great war people's wants get saturated and we find that we have enough homes and cars and factories for the time being. Capital spending shrinks and a more or less serious readjustment ensues. That has been the historical experience.

We have built into the economy many new devices which, like unemployment insurance, support spending power in business recession or, like deposit insurance, eliminate the crippling effects on credit supply of panicky runs on banks. Federal outlays naturally rise in recession while revenues fall off, creating pump-priming deficits quite automatically. Indeed, the general postwar experience suggests that, in our anxiety to avoid another decade of stagnation like the 1930's, we have built into the economy better protections against deflation and unemployment than we have against inflation and upward spiraling wage costs.

Dr. Burns' view in mid-February was that the time had not arrived for "massive" government action. At this stage there is probably more risk in doing too much too soon than too little too late. Time permits the built-in supports to come into play and show what they can do. It allows natural adjustments to occur — corrections of unbalanced inventories and retrenchments of wasteful expenditures. It compels business men to be more careful in accepting higher labor costs which, if they cannot be financed by consumer acceptance of higher prices, must result in reduced production and layoffs. The statesmanship of trade union leadership will be tested if strikes are not to add to the wastage of manpower represented in unemployment. As a distinguished Canadian banker put it recently: "Profits fall first and unions might well at this point temper the wind to the shorn lamb."

A business recession is not an unmixed evil. It may give to the "forgotten man" — the millions living on small fixed incomes — a respite from rising prices. If, as happened in 1954, living costs can be leveled out for two years or longer, more people will be aided by price stability than will be hurt by periods of insured unemployment. As Dr. Neil H. Jacoby, former member of the President's Council of Economic Advisers, has said:

> Price inflation during the past decade has pauperized millions of elderly and disabled Americans living on fixed dollar pensions and annuities. It has painfully squeezed the living standards of school teachers, government clerks, and others on low and inflexible salaries. Since 1941 more human suffering has been visited upon Americans by the doubling of consumer prices than by unemployment. In the face of this record, who will say we need not be as much concerned about a dollar of stable value as about full employment?

Even those temporarily unemployed may benefit in the long run if layoffs lead them to find or learn different trades where qualified men are still in short supply. The process of readjustment demands that individuals be willing to shift jobs. It is by movements within the labor force that industry can adjust production to the fickle and changing wants of the consumer. Our freedom as consumers requires of us mobility as producers. And our freedom as consumers to resist higher prices imposes on employers the necessity to watch payroll costs more scrupulously.

The recession tends to check the wage-price spiral and bolster faith in the dollar. Should leveling of wages, better productivity, and price concessions restore something to the buying power of money, the "forgotten man" would have some redress for hardships wrought by inflation. On the other hand, generalized deflation is un-

desirable. It creates injustices of an opposite sort, multiplies insolvencies to a point where faith in the credit structure is shaken, and leads to a spiraling decline that may require heroic action to arrest and even this may not work immediately.

Alternatives for Policy

At hearings conducted by the Congressional Joint Economic Committee last month, most economists called upon to testify felt that some Federal Government actions would be needed, though there were natural differences on questions what to do, when, and how much. But the viewpoint was widely accepted that the Government should be preparing to act if the business news does not brighten during the second quarter of the year. Meanwhile a number of modest steps have been taken, such as to accelerate placement of government orders and to set in motion plans to improve post-office buildings. The Federal Reserve is releasing $500 million for lending and investing from the idle cash reserves of member banks and generally is conducting its operations to insure a readier availability of credit. These moves, while appropriate and helpful, may not be enough.

One idea, pressed by economists for the AFL-CIO, would be to forget our "petty, penny-pinching prejudices" about a balanced federal budget, accelerate Federal Government spending, and release $2.8 billion of spending power by increasing personal income tax exemptions by $100. While the AFL-CIO at the same time would increase taxation on "wealthy families and corporations," the obvious effect would be to throw the budget irretrievably out of balance and permit the wage-price spiral to resume its operation. The AFL-CIO conception is that wages and also business taxes can be advanced at the expense of profits without price increases. But if prices somehow could be held down the formula would become one for economic stagnation; private business cannot survive and offer employment without profits.

The broad record of history is that decreasing profits lead to decreasing employment. And vice-versa. The first problem of recovery is to brighten the outlook for profits. This can be aided by forbearance with respect to wage and tax demands on industry.

Increased Federal Spending

Another idea is to take just the increased federal spending part of the AFL-CIO prescription. This is the course advocated by "liberals" who sense nothing wrong with the federal tax structure and who in any case feel that the Government knows better how to spend money than does the citizen. Distrustful of the essential American quality of self-reliance, they want more federal programs to aid communities in chronic economic distress, to build schools, to provide public housing for low income families, to raise farm income, to clear slums and to develop natural resources. All these things sound fine until we see that they will be financed by shrinking further the value of the dollar and enforcing more hardships on the "forgotten man." We should know, from our experience in the Great Depression, that uncontrolled increase in government spending is no road to a stable and prosperous economy. In 1938, after years of unbalanced budgets and building federal payrolls up to unprecedented peacetime levels, we still had more than 10,000,000 people left unemployed.

Uncontrolled increase in government spending, while adding to aggregate spending power, raises the spectre of still higher taxes on business. The negative influence of higher taxes largely explains the failure of the economy to regain stable prosperity in the 1930's.

A more moderate approach — with the accent still on spending — would be to hasten public works projects where the planning has been done and the projects can be completed within a comparatively brief period. Thus expenditures would bulge only as a temporary matter.

This looks good in theory. One difficulty would be to find projects which are at once useful and located in sections of the country where labor is available. Another would be to avoid making the plan a political grab bag where, regardless of needs, every Congressman would be expected to get some "federal funds for free" in his district. Again there is the problem of shutting off the program, once begun. Finally, many people laid off from jobs would not be qualified for vigorous outdoor work. Construction workers — at least those willing to move and if necessary shift job classifications — have little lack of job opportunities now. Public works expenditures, and also total construction expenditures, are already running at record levels.

Stimulation by Tax Relief

Percival F. Brundage, Director of the Budget, speaking in New York February 25, pointed out that "it will be perhaps a year" before an extended public works program would channel down to the public at large. On the other hand, he said, a tax cut would take effect immediately: "Taxes are too high, anyway." This idea is receiving increased support. It does not seem sensi-

ble for the Federal Government to hunt around for places to put more money into circulation when it is demanding in taxes around half of business profits and 10 to 15 dollars a week out of the average household budget. There is no end of stimulus available through tax reductions. The problem is to limit the stimulus to what is needed and retain a tax structure that can quickly restore a balanced budget when business recovers.

One idea is to make a tax cut temporary, even to the extent of suspending personal income taxation for a period. This would be intended to insure a return of flush revenues and a balanced budget once the economy by this means had been re-energized. One thing is certain: people able to adjust the timing of their incomes and tax deductions could have a field day. The most likely outcome would be a temporary spurt of activity. This is what happened in 1930 after a temporary federal tax cut. The sequel was still higher taxes in deepening depression.

Permanent tax concessions, even on a moderate scale, would be more likely to have beneficial lasting effects. One popular approach is to put the primary emphasis on increasing consumer buying power. This approach underlies the proposal to raise the personal exemption from $600 to $700, excusing 4,200,000 persons from income tax, removing perhaps $14 billion from the personal income tax base and giving up about $2.8 billion in annual revenue. This has a good many objections. It would further enlarge the already overswollen magnitude of tax exempt income and neglect the excessive rates which throttle initiative and revenue by promoting tax avoidance. With so many persons excused from the income tax rolls, and no incentive to anyone to develop more taxable income, the recovery of revenues and rebalancing of the budget would be a tardy process. Congress would be saying in effect that it has no intention ever of easing income tax rates, individual and corporate. Indeed, still higher rates to balance the budget would loom as an active threat to enterprise.

Congressman Robert W. Kean of New Jersey has suggested cutting the rate on the first $1000 of taxable income by 10 per cent and other rates by 5 per cent for a revenue loss of about $2½ billion. There is, of course, an infinite number of combinations. A flat 5 per cent cut in rates (or in tax) would involve about $1.9 billion. This would be a simple and quick way to relieve the rate problem.

The trouble with cutting the initial 20 per cent rate very much is that this is the rate that brings in around three fourths of the personal income tax revenues. Everyone who pays any income tax pays something at the initial rate. Tens of millions are touched only by this rate on varying fractions of their gross incomes. When government is so expensive the cost must be shared among the mass of the population. Unfortunately, there are not enough rich people left to carry the major burden.

The best solution would be to redraw the basic progression, inherited from World War II. Because of price inflation, the war-inherited personal income tax scale takes an even heavier share of personal income now than it did when first put in force. Unless something is done about the progression, personal income taxes get steeper and steeper to a point of suffocation.

An "Income Tax Depression"

The tax which attracts the most attention is the personal income tax with all its well-advertised inequities. Time and again revision of rates has been postponed because it would be "inflationary." For similar reasons — and perhaps also because corporations cannot vote — scheduled reduction of the corporate income tax from 52 to 47 per cent has been postponed year after year.

The House Ways and Means Committee, which has been holding hearings on the question of tax reforms, has listened to some eloquent testimony on the discouragements of taxation. Tyre Taylor, representing the Southern States Industrial Council, testified that the present "near-confiscatory individual and corporate income tax rates" are "so fantastically high as to be, in a quite literal sense, self-defeating." From a strictly revenue standpoint, he added, "they have passed the point of diminishing returns and we are now threatened with what someone has aptly called an 'Income Tax Depression'."

The Ways and Means Committee got a good straight account, from a long succession of witnesses who could speak from first-hand knowledge, of the tax discouragements faced by enterprising people in the United States. As Tinsley W. Rucker, president of a small company in Jacksonville, Florida, reminded the Committee:

> In our type of free society, we don't accomplish things by cracking a whip. We offer inducements and opportunities for men which lead them to work and plan and save.
>
> Ours is far and away a better method, but it cannot be stifled if it is to give us the needed results.
>
> We have paid lip service to the dignity of human effort and achievement, but have a tax system whereby the harder a man works and the more he earns, the less his efforts mean to him.

. . . Would it have been possible for us to enjoy the benefits in our homes today had the companies which produced these fine products been shackled with such a tax load in their growing years? Are we by our tax structure going to eliminate the growth of new industry? . . .

Shackles On Progress

H. W. Prentis, Jr., chairman of the Armstrong Cork Company, once observed that people generally do not realize what has been done to them with taxes at their present levels:

We should never forget that, while the welfare of the so-called common man is of vital importance, it is only through the initiative and ingenuity of the uncommonly gifted individual that the general well-being can be further advanced.

Some specific evidence of what these taxes have done was offered the Committee by Robert A. Ewens, executive vice-president of the Wisconsin Manufacturers Association:

There is no question that the most vexing problem is that of taxation. As now constituted, it insures, among other things, a growing monopolistic trend because it stifles growth. . . .

Risk capital supplied by individuals built Wisconsin industry. Men willing to gamble a few thousand dollars or tens of thousands of dollars on an idea were encouraged to do so by tax laws which did not penalize the accumulation of wealth or its reconstitution if impaired.

That is what built the plants that now employ 2,000, 5,000, 25,000 in my state.

It is significant that not since 1930 have we had in Wisconsin an instance of a single company growing from humble beginnings to stature as one of our leading industrial establishments.

. . . Piecemeal corrective tax legislation to rectify these situations is not the answer. A patchwork to aid special groups evades basic principles. Industry is indivisible. It cannot be divided into small and large.

. . . If we are in truth a free people, our government must abolish confiscatory policies such as now permeate our tax laws, and we must restore the spirit of enterprise and reward to small and large alike, treating one citizen as another.

John A. Gosnell, general counsel of the National Small Business Men's Association, reminded the Committee that:

We are engaged in a long, grueling race against the Soviets, the outcome of which will not be determined by isolated, though dazzling, achievements such as the "sputniks", but will be by long-range economic staying power.

The time has come, at long last, to recognize that this staying power cannot be developed under a tax rate structure which cripples the fundamental economic process.

The Imaginative Approach

Dr. Charles F. Phillips, an economist and president of Bates College, pointed to the falling federal revenues under the impact of recession and urged "a carefully planned program for a reduction in taxes" as the way to regain a balanced budget. "With lower rates," he said, "we may well help to generate an upswing in economic activity which will give us the total revenue we need to meet our essential expenditures and still keep a balanced budget." That is what we did in 1954.

Dr. Phillips, and numerous other witnesses including all those quoted above, spoke in advocacy of the Sadlak-Herlong bill which would reform the income tax structure over a five-year period and wind up with a rate schedule running from 15 to 42 per cent for individuals and a 42 per cent rate for corporations. It is doubtful if there is any action Congress could take that would so brighten the economic outlook and revitalize efforts to produce and sell and go ahead.

This bold approach, curiously, is also the one which, with reasoned control over federal expenditures, would hold the highest promise of rebalancing the budget. There is no question but that more taxable income would be earned and reported under an easier set of rates.

Prosperity demands more than cheaply-created money purchasing power; it demands enterprising work effort. If Congress wants private enterprise to offer more employment the means are readily at hand to make it possible.

Getting Ahead in the World

Capitalism, according to its opponents, exploits the many to pile up wealth and income for the few. Socialism, according to its proponents, redistributes the wealth and income among the masses of the population and brings about "social justice and equality."

Of course the highest form of generosity is to give willingly. Modern socialism denies this opportunity: stirring the lust of the poor for the property of the rich, and doubting the charitable instincts of the individual, it redistributes forcibly through the tax system. Loss of opportunity takes the zest out of life for those who, in other circumstances, might have built great enterprises and made great gifts. Government meanwhile accumulates more and more dependents, removed from the labor force. The growing tax burdens shift inexorably toward the same masses whom the socialist state is intended to help. In the end everyone is poorer than he would have been if rare and gifted individuals had been stimulated to go ahead and seek out new and better ways to produce and satisfy human wants.

There are sufficient differences in social arrangements in various countries so that it is possible, out of the postwar experience, to test the

principles of real progress. If, as some say, Russia is moving ahead of us in science, it may be that our system of taxation, and liberal social benefits, have some responsibility. Paradoxically, the Soviets give greater financial incentives to rarely gifted individuals than we do.

Professor David McCord Wright, of McGill University, has made a close study of comparative policies and results in West Germany and the United Kingdom since the war. In a pamphlet published in December by the American Enterprise Association, he notes:

> . . . We have a most interesting test case of the effect upon the condition of the poor of a relatively free market economy as against one heavily paternalistic, controlled and subsidized. . . .
>
> . . . Offhand, the deeper concern of labor socialists and to some extent of the present U.K. economy with the condition of the poor would seem to be the fastest way to raise the income level of the lower income groups. But it hasn't worked out that way!

The "German Miracle"

The economic choice faced by West Germany, after the currency reform and granting of substantial autonomy in 1948, was a basic one, according to Professor Wright:

> Had she followed the prevalent European and U.K. labor pattern she would have gone in for heavy control, rationing, state directed investment, sharply progressive taxation, tremendous emphasis on equality.
>
> Instead her policies were entirely different. Emphasis was placed upon incentive rather than literal equality, upon a free market rather than planning, upon modernization rather than routine. . . .

The decision to adopt the *Marktwirtschaft* – the free-market economy – has paid off handsomely. West Germany, phoenix-like, has risen from the rubble of World War II to economic and financial pre-eminence in Western Europe – a rise that has been aptly called the "German miracle."

This particular "miracle" lends itself to statistical measurement – as can be seen in the charts.

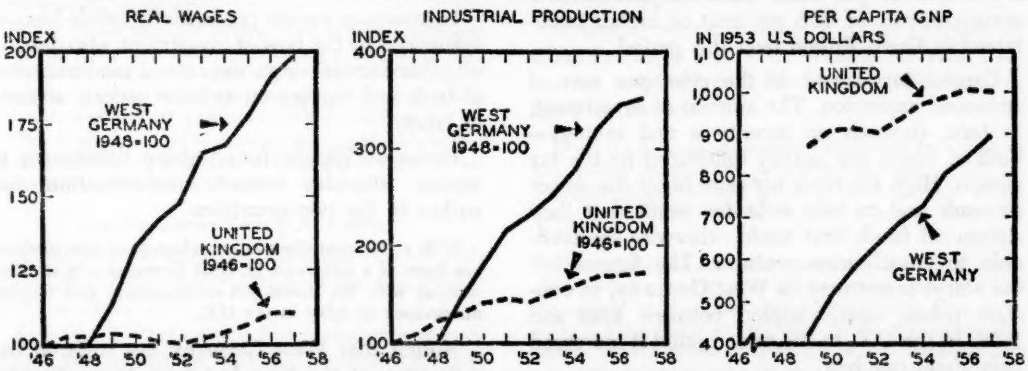
West German workers' real wages (adjusted for price increases) advanced 99 per cent between 1948 and 1957. In Britain real wages went up only 11 per cent measured from 1946, two years earlier, when its postwar expansion began. Industrial production in Germany in 1948-57 soared 254 per cent while in the U.K. (1946-57) it went up only 70 per cent. Per capita output of goods and services (1949-57), in constant prices, rose 115 per cent in Germany as against 15 per cent in the U.K.

In the early postwar years, of course, West Germany's level of production was small in relation to Britain's so its percentage increases would naturally be larger.

But it is significant that Germany has kept right on progressing at a more rapid rate. Between 1954 and 1957, gross national product, in real terms, rose more than 25 per cent in Germany – as against only 4 per cent in the U.K.

Houses, Cars, and Ships

In the field of particular industries, there has been similar dramatic improvement. West Germany in the past seven years has built more housing than the U.K. built in eleven. Since the population in both countries is the same – about 51,000,000 – per capita housing output in Germany has also run well ahead. Starting from scratch in 1948, West Germany last year had moved up to third place among the world's shipbuilders. In 1948 some 328,000 autos rolled off assembly lines of British factories while only 30,000 were produced in West Germany. Last year German auto output amounted to 950,000 cars – some 100,000 above the U.K.'s.



Postwar Changes in Real Wages, Industrial Production, and Per Capita Gross National Product in United Kingdom and West Germany. (Indexes of wages and production based on 1946 — 100 for U.K. and 1948 — 100 for West Germany, 1957 partly estimated. Per capita GNP in 1953 U.S. dollars.)

In the field of world trade, German exporters, combining high quality with attractive prices, have been able to acquire a growing share of world commerce. While the U.K.'s share of world exports slipped from 12 per cent in 1949 to 10 per cent in 1956, Germany's share advanced from 2 per cent to 8 per cent.

The success of Germany's export drive enabled it to nearly triple its imports between 1950 and 1957 and still make solid additions to its gold and foreign exchange holdings. Starting from practically nothing in 1948, these reserves at latest count amounted to $5.7 billion – well over double those of the U.K.

The German mark has become one of the world's most respected currencies. An important reason for this has been Germany's application over the postwar period of orthodox financial policies to contain inflation – *i.e.*, restraint on government spending to produce an over-balanced budget and tight credit policies to limit borrowing and encourage saving. Moreover, German labor leaders, unlike their British counterparts, have exercised restraint in wage demands. Thus, while the cost of living has gone up 44 per cent in the U.K. since 1950, it has increased only 18 per cent in Germany.

Lower Tax Rates Speed Expansion

What made this economic "miracle" possible? Professor Wright gives a major share of the credit to a sharp reduction in West German personal income tax rates.

In 1948 West German tax rates went as high as 95 per cent. However, an elaborate system of special exemptions for saved and invested income largely nullified the impact of these high rates. Beginning in 1950 the rates themselves were gradually revised downward until now the top rate is 55 per cent. This compares with a maximum rate of 92½ per cent or higher maintained in Great Britain over this period.

Capital investment is the *sine qua non* of economic expansion. The amount of investment, in turn, depends on incentives and savings – both of which are heavily influenced by the tax system. High tax rates not only blunt the desire to work and to take risks for profit, but they siphon off funds that could otherwise be available to launch new ventures. The figures tell the story: investment in West Germany, in constant prices, nearly tripled between 1949 and 1956. In the U.K. in the same period it increased only about one half.

Dr. Robert G. Wertheimer, of Babson Institute, recently completed a five-year study of the postwar German tax structure. His statement last month before the House Ways and Means Committee concisely spells out what was accomplished by the German tax reforms:

> Not only did the economy grow more rapidly than ever in a climate of stable prices but total public revenues also expanded and secured a balanced budget. Income tax reductions set free entrepreneurial initiative which created a flexible economy providing full employment (in spite of the influx of ten million destitute persons), steadily rising standards of living and a rapidly growing domestic and foreign investment.
>
> Taxpayers again could show their incomes and profits without the fear of seeing most of them taxed away. The lowering of the tax rates rapidly increased the ability of all classes to save. Institutionalized saving, for example, increased from 4 per cent of the disposable income in 1950 to 8 per cent in 1955. Business saving in the form of retained profits and depreciation allowances rose even more rapidly. These savings made possible the financing of the German reconstruction without inflation. . . .
>
> The lesser dependence of the federal government on personal income taxation as source of tax revenues also solved the plight of the small businessman by permitting him to keep most of his gross profits as seed capital for expansion. The lower income tax burden stimulated the general willingness and ability of people to take risks and to establish new business or to expand existing ones. Wage earners and the professions also became more productive and were eager to work longer hours, overtime, and on outside projects to expand incomes that would accrue to themselves.

Output and "Labor Attitudes"

The huge sums poured into new factories, machines, equipment, and processes (gross investment of $50 billion in Germany between 1949 and 1956 as against $43 billion in Britain) played a big role in the phenomenal increase in German worker productivity. Output per man-hour in Germany between 1948 and 1957 increased 116 per cent – as against only 37 per cent in Britain between 1946 and 1957.

Increases in worker productivity, while heavily influenced by the flow of investment, also depend on other factors – *e.g.*, the rate of modernization of tools and equipment and the general attitude of labor.

Professor Wright found sharp differences in worker attitudes toward modernization and strikes in the two countries:

> With a few exceptions union sabotage of new methods has been at a minimum in West Germany – in startling contrast with the frantic job consciousness and routine-mindedness of labor in the U.K.

Noting that West Germany has suffered but a fraction of the time lost from trade disputes that the British economy has since 1949, he added:

The sense of crisis felt by the whole of West Germany and the intense desire of all classes to rebuild the country created a public opinion, both inside and outside the unions, that would not have tolerated anything like the degree of slackness . . . put up with in the U.K.

Armament Burdens

One objection often made to the comparison of West Germany and the U.K. is the presence for the U.K. of a great armaments burden. It should be noted, however, that Germany had more reconstruction to do, relatively speaking, than the U.K.

Professor Wright's assessment of these burdens is closely tied in with the different labor attitudes in the two countries:

While the presence of an armament burden would have made the West German economy start from a lower level, a nation whose labor force was so much more cooperative . . . and so much more willing to accept change would have had about an equally rapid *rate* of increase of output.

Had the unions of the U.K. followed the behavior pattern of those in Germany, the U.K. would have borne its arms burden and continued to expand relatively easily.

Peter Thorneycroft, who resigned in January as Chancellor of the Exchequer in a dispute over a continued rise in government spending, lists the defense burden as only one of the reasons for Britain's financial troubles. The *New York Times* of January 24 carried this account of Mr. Thorneycroft's penetrating analysis:

First we have sought to be a nuclear power, matching missile with missile, anti-missile with anti-missile and with large conventional forces in the Far East, Middle East and Atlantic.

At the same time we have sought to maintain a welfare state at as high a level, sometimes even at a higher level than the United States. We have been trying to do these things against a background of having to repay debts abroad during the next eight years at a total equal to the whole of our existing reserves.

It was not a mean thing to have attempted these things but no politician should be under any illusions as to what it has meant.

It has meant that for twelve years we have slithered from one crisis to another – sometimes a balance of payments crisis, sometimes an exchange crisis, but always it has been a crisis. It has meant a pound sterling which has sunk from twenty shillings to twelve shillings.

This is not a picture of a nation we would wish to see. It is a picture of a nation in full retreat from its responsibilities. It is the road to ruin.

Implications for U.S. Policy

A number of important lessons can be drawn from the sharply-contrasting German and British postwar experiences.

One is the vital role of free enterprise in providing the incentives and the competitive effort which deliver a growing and widely-diffused prosperity while preserving individual freedom.

Ludwig Erhard, Germany's Economics Minister and a staunch supporter of the free market economy, pointed this up in the October 28th issue of *Time:*

The most successful means for the achievement and retention of prosperity is competition. Only by competition can an economy expand to serve all people, especially in their capacity as consumers, and dissolve all advantages which do not result directly from higher performance. Free competition thus leads to progress and profits for the whole social order.

Another lesson is the clear impetus given to production and workers' rewards by labor policies which do not impede technological progress. German labor's receptive attitude toward industrial innovation has paid off in rapid wage increases many times over.

Yet another lesson can be drawn from the differences in what Professor Wright calls "social attitudes" in the two countries:

A famous English scientist once summed up . . . the difference between a socialist and capitalist in the following terms: "A capitalist," he said, "is a man who, if he himself is living well, doesn't mind if others are living better. A socialist, on the other hand, is a man who doesn't care how badly he himself is living as long as nobody else is allowed to live better."

Possibly, in the difference in the two attitudes indicated here, one may find something of the basic reasons for the "German Miracle."

Finally, there is a lesson for socialist planners who, in striving for income "equality," use extortionate tax rates to take away income from the gifted, hard-working individual and "spread it around to the less fortunate" through various government welfare schemes.

Germany, as we have seen, has chosen a different route – one that has yielded more income for everybody. With sharply reduced tax rates and heroic work effort, Germany has achieved unparalleled prosperity.

Germany serves, thus, as a prime example of what Professor Henry C. Wallich, of Yale University, pointed up in the autumn 1956 issue of the *Yale Review:*

If we try to even up income distribution by means of progressive taxation, we reduce savings and curtail investment incentives and so slow down growth. If we want to accelerate growth, we have to accept inequality of income. . . .

From a dollars-and-cents point of view, it is quite obvious that over a period of years, even those who find themselves at the short end of inequality have more to gain from faster growth than from any conceivable income redistribution. A speed-up in real output of only one extra per cent per year will soon lift even the economically weakest into income brackets to which no amount of redistribution could promote them.